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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED

MAR - 6 1991

Federal Communications Commission
Office of the Secretary

In the Matter of CENCOM CABLE INCOME PARTNERS, II, L.P. CENCOM CABLE ENTERTAINMENT, INC.,; and CENCOM CABLE TELEVISION, INC., Complainants, v. DUKE POWER COMPANY, Respondent.	)	CC 95-93 File No. PA-91-001

TO: The Common Carrier Bureau

<u>REPLY</u>

Paul Glist
COLE, RAYWID & BRAVERMAN
1919 Pennsylvania Ave., N.W.
Suite 200
Washington, D.C. 20006

March 6, 1991

SUMMARY

The Reply reviews established Commission precedent which support the pole rent calculations set forth in the Complaint.

- Duke's cost of capital must reflect its overall cost for equity and debt, not just its higher return on common equity.
- Duke's effort to use "gross" calculations is inconsistent with specific Commission instruction and would allow Duke to earn a return illegally on substantial pole plant erected at the cost of the cable industry.
- Duke's efforts to retroactively increase pole rents cannot evade the FCC's power to grant refunds.
- Duke's request to be compensated for extraordinary costs of Hurricane Hugo are unsubstantiated and inconsistent with its statements to shareholders. If Duke is believed, the costs can only be accounted for in a net adjustment of 3 cents per pole.
- Duke has presented no basis for adjusting correct and settled tax and ADIT calculations.

TABLE OF CONTENTS

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CENCOM CABLE INCOME PARTNERS, II, L.P.; CENCOM CABLE ENTERTAINMENT, INC.; and CENCOM CABLE TELEVISION, INC.,	)	
	)	
Complainants,	)	
	)	
v.	)	File No. PA-91-001
	)	
DUKE POWER COMPANY,	)	
	)	
Respondent.	)	

TO: The Common Carrier Bureau

REPLY

Complainants Cencom Cable Income Partners, II, L.P.; Cencom Cable Entertainment, Inc. and Cencom Cable Television, Inc., ("Complainants") hereby reply to the "Answer" filed by Duke Power Company.

DISCUSSION

A. Duke's Cost of Capital Must Reflect the Overall Weighted Cost of Capital, Not Its Return On Equity

1. Duke has admitted that its overall weighted cost of capital is 10.66% in South Carolina, rather than the 13.0% return on equity. This reflects the lower cost of debt (and other capital instruments) than of common equity. Duke's substantial debt borrowings are a matter of record. According to

its 1989 Annual Report to Shareholders, as filed with the SEC, its total capitalization is 51% common equity, 40% long term debt, and 9% preferred and preference stocks. Exhibit C, pp 26, 31, 38.

2. Duke offers no defense to its efforts to charge more than its actual cost of capital, except that its practice began in response to a 1979 and a 1982 complaint, prior to the authoritative FCC rulings cited in the Complaint. In <u>Booth American</u>, Duke refused to comply with a legitimate information request to identify its overall cost of capital (Complaint in PA 82-0068 at p. 9, App. B, D), then alleged in Response that SC PSC had established a "rate" of 13.00% (Response in PA 82-0068 at p. 8, Att. A, p. 2). It then followed the <u>Teleprompter</u> calculation without ever identifying the "rate" as the rate of return <u>on</u> equity. In <u>Teleprompter</u>, Duke had again refused to comply with an information request (Complaint in PA 79-0049 at p. 3), and alleged only a "cost of capital" component without ever distinguishing its overall return from its equity return (Response, p. 11, Att. A).

3. Despite Duke's suggestion to the contrary, nothing in the orders in those cases or in the pleadings put this matter in issue. In 1981, the Bureau's practice was <u>expressly</u> not to recalculate carrying charges unless there was a facial inconsistency with the FCC's rules. <u>Eastern Shore Cable</u>

Television, Inc. v. Delmarva Power & Light Co. of Maryland, PA 81-0011, 49 R.R.2d 1069 at ¶ 10 (1981). In later years, the Bureau explained that on this very issue -- whether to use equity or overall return -- the proper figure was overall, but the Bureau would not itself challenge the use of equity if the parties did not. Trenton Cable TV v. Missouri Public Service Co., PA-81-0037, Mimeo 2109 at ¶ 6 (Jan. 25, 1985). In fact, the Bureau ruled generically that its older rulings accepting carrying charges without contest were not precedential. King Video Co. v. Idaho Power Co., PA-82-0004, Mimeo 2719 at ¶ 9 (Mar. 12, 1982).

4. Annual carrying costs for a pole are not determined against a fictitious 100% equity financed utility. They must be based on the real cost of capital, as has been settled by Commission law. Trenton Cable TV, Inc. v. Missouri Public Service Co., 50 R.R.2d 1395, 1398 n.7 (1982), recon. denied, Mimeo 2109 (Jan. 25, 1985). The use of equity return overstates the required revenue per pole significantly. If Duke's net cost per bare pole is $153.46, the use of an equity return raises the pole attachment rate by more than 25 cents per pole -- a substantial overcharge when one considers that there are over 11,000 poles involved in this case and nearly 46,000 in the related case filed January 15, 1991.

B. Duke's Carrying Costs Must Reflect "Net" Calculations to Recognize FCC Case Law and Makeready Payments by Cable

5. As noted in the Complaint, under Commission rule and precedent, calculations are preferred when they reflect pole investment net of depreciation. Riverside Cable TV, Inc. v. Arkansas Power & Light Co., PA-85-0001, Mimeo 4813 at ¶ 4 (June 30, 1985); 47 C.F.R. § 1.1404(g)(3), (g)(9); Amendment of Rules, 2 F.C.C.Rcd. 4387, 4406, n.21 (1987).

6. One reason the preference is important is because of utility accounting for "makeready" payments by cable operators. As the FCC has recognized repeatedly, cable television operators reimburse utilities for the costs of rearranging pole plant or replacing poles with taller poles to accommodate cable attachments. Second Report & Order in CC Docket No. 78-144, 72 F.C.C.2d 59, 62-63 (1979), Memorandum Opinion & Order in CC Docket 78-144, 77 F.C.C.2d 187, 191 (1980), Amendment of Rules, CC Docket 86-212, 2 F.C.C.Rcd. 4387, 4394 (1987).

7. Depreciation in utility accounting is used for capital recovery. Accounting for Public Utilities, § 6.03 (Mathew-Bender, 1990). As Duke admits, it adds the makeready payments to its distribution depreciation reserve. Duke admits that about ½% of its additions to distribution depreciation in 1988 and 1989 reflected makeready. Duke, however, has been less

10. Duke, of course, has not volunteered the total amount of makeready cumulated in its pole depreciation reserve. "Where one of the parties has failed to provide information . . . or where costs, values, or amounts are disputed, the Commission may estimate such costs, values or amounts it considers reasonable, or may decide adversely to a party who has failed to supply requested information which is readily available to it, or both." 47 C.F.R. § 1.1409(a). TeleCable has submitted an appropriate estimate in PA-90-003, which we endorse. Makeready is a significant payment which must be accounted for.

11. Duke states that it does not earn a return on this makeready because it has adjusted its equity return for application to gross. However, as demonstrated in Part A, Duke has <u>not</u> properly accounted for its cost of capital in the first place, so its adjustment does not avoid the problem of overearning on makeready payments. Plainly, Duke has not comported with the letter or spirit of the FCC rules.

12. Only <u>net</u> calculations properly account for makeready. As far back as the <u>First Report & Order</u> the Commission explained that netting out depreciation reserve from investment was standard practice before regulatory bodies; and that it would expect an explanation if a utility did not maintain accounts in that fashion for the PSC. 68 F.C.C.2d 1585, 1593-94. The FCC rejected Edison Electric Institute's[1/] claim to the

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1/ Edison Electric Institute is the national trade association of investor owned electric utilities like Duke Power.

than forthcoming as to the total impact makeready has on pole depreciation.

8. In the first place, makeready payments are properly compared to _pole_ depreciation, not total _distribution_ plant, of which poles comprises only 18.371% (Complaint, Exhibit A, Sch. 1). Thus, ½% of _distribution_ depreciation expense is 3% of _pole_ depreciation expense. Second, _additions_ to depreciation reserve, which is the figure Duke advances, _cumulate_ over time. The additions to depreciation reserve in 1988 and 1989 reflect only two years out of a thirty year cumulation in depreciation reserve. As the Commission has recognized, makeready payments are very large during initial plant construction. Second Report & Order, 72 F.C.C.2d at 62-63. Complainants' principal plant was built long before 1988 and 1989. One cannot get a true picture of makeready reflected in depreciation reserve without looking at the _cumulative_ payments over time, as they are added to the depreciation reserve.

9. Cencom has built over 978 miles of plant since 1975 -- and Cencom is only _one_ of scores of cable operators in Duke's service area. As TeleCable has demonstrated in PA-90-003, cable makeready was booked to depreciation reserve long before 1988. 1988 and 1989 additions to reserve give no reflection of the significant makeready payments by cable operators, which can only be recognized through pole calculations which net out pole depreciation reserve.

contrary, and formulated a list of elements -- including pole depreciation reserve -- which it deemed "useful in determining the costs incurred by a utility to install pole plant." Ibid. 47 C.F.R. § 1.1404(g)(3) (requiring use of pole depreciation reserve as part of maximum pole attachment rate). Duke does submit its rate base to the SCPSC net of depreciation: that is why its authorized return is for application to net, and Duke must convert it for application to gross. Duke is departing from standard accounting merely to increase its pole attachment rate beyond the lawful maximum.

13. Duke claims that there is no case in which the Commission has rejected gross figures. This is not true. The Commission has often rejected a utility's "gross" calculations in preference to a cable operator's "net" calculation which follows FCC rules. See, e.g., Riverside Cable TV, Inc. v. Arkansas Power & Light Co., PA-85-0001, Mimeo 4813 at ¶ 4 (June 30, 1985). The cases Duke relies on to endorse "gross" calculations are from cases arising in 1979 and 1982 -- which, as has been explained above, are not precedential.

14. Duke's suggestion that depreciation be ignored because it is inexact is preposterous. As Accounting For Public Utilities puts it, quoting the FCC's explanation of depreciation accounting:

> Recognition of the inability of individuals to achieve absolute precision in arriving at various accounting measures however, should not diminish the striving for such measures.

§ 6.12 at 6-50. Nor is there any basis, as suggested by Duke, to use "gross" calculations in an effort to "minimize the use of estimated components." Contrary to Duke's claim (Answer, p. 14, n. 14), Duke already reports the depreciation reserve attributable to distribution plant. (FERC, p. 219, line 24, col. C, Exhibit A to Complaint).

C. The Commission Has Ample Jurisdiction to Remedy the Rate Overcharge and Still Permit Prospective Incorporation of More Current Data

15. Duke contends that the Commission has no jurisdiction to resolve this rate complaint, because Duke's contract provides that it may retroactively adjust the $4.87 rate now in effect to account for data which is not yet available. Duke goes so far as to suggest that the rate it has billed and collected "does not yet exist" (p.11).

16. There is a very simple arrangement, routinely employed by the Commission, to allow exercise of its jurisdiction while permitting the future use of data as it becomes available. At any moment in time, the maximum lawful rate should be that calculated from publically available current information. This provides a structure conducive to simple resolutions and to

private settlements, principal goals of the Pole Act and the Commission's rules. E.g., Teleprompter Corp. v. General Telephone of the Southwest, 49 R.R.2d 1501, PA 80-0016, Mimeo 1985 at ¶ 11 (July 14, 1981), rev. denied, Mimeo 33920 (Oct. 24, 1983). Thus, the present $4.87 rate must be judged against the data Duke itself has relied upon for justification (year end 1989, employed for its December 1990 billing).

17. After the Commission reaches judgment, Duke is free to employ such data as may become available this year to set prospective rates without resort to the FCC. Teleprompter Corp. v. New England Telephone & Telegraph Co., PA 79-0044, Mimeo 34556, p.3 n.3 (Apr. 18, 1984). If the data becomes available pending FCC decision, Duke may still use it (within FCC formula) for prospective rates. Tower Cablevision v. Kentucky Power Co., PA 79-0011, Mimeo 3601 (Sep. 29, 1981).

18. What Duke may not do is to claim a right of retroactive adjustment which divests the FCC of jurisdiction; nor may it claim that its rate may be justified by data which is not available for ratemaking for the period at issue. To give it that right would nullify the purposes of the Pole Act.

19. Duke also contends that no refunds are appropriate because the overcharge is not "substantial." Complainants consider Duke's overcharge each year to be substantial, even if Duke does not. In any event, there has never been a rule that utilities may violate the statutory maximum, but only a little.

D. Maintenance

20. Complainants employed the Commission's precedent and rule that maintenance expense was to be calculated by dividing Account 593 by the sum of Accounts 364, 365 and 369. 2 F.C.C.Rcd. at 4402.

21. Duke claims that this formulation omits costs associated with May 1989 tornadoes and with Hurricane Hugo booked in subaccount 407.3.

22. Account 593 is the FERC account designated for "the cost of labor, materials used and the expenses incurred in the maintenance of overhead distribution line facilities, the book cost of which is included in Account 364, Poles, Towers and Fixtures, Account 365, Overhead Conductors and Devices, and Account 369, Services." 18 C.F.R. Part 101 § 593. It relates expenses directly related to the pole at issues. The Commission has repeatedly held that Account 593 most closely approximates a utility's true maintenance expense.[2/] The Commission also seeks

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2/ Teleprompter Corp. v. Tampa Electric Co., 50 R.R.2d 969 (1981), recon. denied, PA-81-0041, Mimeo 6683 at ¶ 12 (Sep. 26, 1983) (Account 583); Accord, Teleprompter Corp. v. Florida Power & Light Co., PA-81-0017, FCC 83-562, Mimeo 34089 at ¶ 14 (Dec. 5, 1983) (Accounts 588, 589, 590). Teleprompter Corp. v. Alabama Power Co., PA-81-0014, Mimeo 001808 at ¶ 15 (June 29, 1981) (Account 590), aff'd, Mimeo 33976 at ¶ 7 (Nov. 3, 1983); Warner Amex Cable Communications, Inc. v. Florida Power & Light Co., PA-82-0016, Mimeo 4414 at ¶ 12 (June 8, 1982) (Accounts

[Footnote cont'd.]

to avoid using subaccount data, to avoid reliance on nonverifiable internal records and to avoid unnecessary complexity.[3/]

23. No one doubts that cable systems and utilities suffered damage from tornadoes and from Hurricane Hugo. Duke claims that SCPSC authorized the capitalization of $50 million and the expensing of $23 million over five years through account 407.3. Duke presents no order of the SCPSC, nor the page from its FERC showing A/C 407, nor internal accounts to verify the sub account data, nor evidence that Subaccount 407.3 relates to poles

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[Footnote cont'd.]

588,590) aff'd., Mimeo 34089 (Dec. 5, 1983); Teleprompter Corp. v. Florida Power & Light Co., PA-81-0017, Mimeo 2095 at ¶ 8 (July 14, 1981) (Accounts 588, 598), aff'd., 54 R.R.2d 1391 (1983); Continental Cablevision of New Hampshire, Inc. v. Public Service Co. of New Hampshire, PA-81-0046, Mimeo 3249 at ¶ 11 n.8 (Apr. 9, 1982) (Accounts 588, 589, 590); Panhandle TV and Cable Company Inc. v. Potomac Edison Co., PA-83-0019, Mimeo 5979 at ¶ 11 (Aug. 15, 1984); Texas Cablevision Co., v. Southwestern Electric Power Co., PA-84-0007, Mimeo 2747 at ¶ 10 (Feb. 26, 1985) (Account 590); Continental Cablevision of New Hampshire, Inc., v. Concord Electric Co., PA-82-0074, Mimeo 5536 at ¶ 13 (July 3, 1985) (Account 583); Liberty TV Cable, Inc. v. Gulf States Utilities Co., 49 R.R.2d 843 (1981). Warner Amex Cable Communications, Inc. v. Southwestern Electric Power Co., PA-82-0017, Mimeo 2718 at ¶ 8 (Mar. 12, 1982), rev. denied, FCC 84-655 (Jan. 7, 1985) (Account 590).

3/ Warner Amex Cable Communications, Inc. v. Arkansas Power & Light Co., PA-82-0019, Mimeo 100 at ¶ 13 (Oct. 11, 1983). S. Rep. 95-580, 95th Cong. 1st Sess. at 20. ("[T]here may be some difficulty in determining the components of "actual" capital costs. As to some of these factors, the Committee expects that the Commission will have to make its best estimate of some of the less readily identifiable actual capital costs.")

rather than to Duke's other plant. Its Annual Report to Shareholders presents a different picture. In it, Duke states that together the NC and SC PSC's authorized only $44 million in capitalization (to be depreciated over 30 years) and $23 million of Hugo and tornado costs to be expensed over 5 years. (Exhibit C, p. 37.) It reports that plant maintenance expenses actually declined from 1988 to 1989 (Exhibit C, p. 23), and that "Earnings were not significantly affected by Hurricane Hugo or a series of tornadoes that struck the service area in May." (Exhibit C, p. 2). Duke's allegations are therefore neither substantiated nor consistent with its Annual Report. There is insufficient evidence in the record to accept the naked assertions by Duke.

24. If credence is given to Duke's unsupported figures, it may not be added to Duke's "gross" calculations. Account 407 (and its companion Account 182) are designed to recover "extraordinary losses on property . . . which are not provided for by the accumulated provisions for depreciation or amortization." 18 C.F.R. § 101.182, 101.407. Duke's insistence on "gross" calculations -- in which capital recovery of distribution plant investment is effectively ignored -- is fundamentally inconsistent with its insistence that extraordinary capital recovery charges be allowed yet ordinary capital recovery charges are ignored. Duke cannot have it both ways.

25. If the Commission gives credence to Duke's allegations concerning A/C 407.3, it may use a maintenence expense figure of $48,985,761 plus $1,743,584; but only if the Commission adheres to "net" calculations which reflect all aspects of capital recovery, including makeready. The result would be an additional 0.27 points in net maintenance costs ($48,985,761 + $1,743,584 : denominator shown in Complaint Exhibit A, Sch. 2), for a "maintenance" carrying charge of 7.76%. The result is a net increase of pole rental of 3 cents, for a final result of $4.22.

E. Complainants have Properly Calculated Taxes

26. Complainants calculated the tax component of the carrying charge using the Commission's accepted formula, comparing accrued total taxes with total utility plant.

27. Duke wishes to increase the tax component by comparing accrued total taxes solely to electric plant. It does not contend that no taxes are paid on its water or transit businesses, nor is there any support for its claim that Duke's formulation "more closely approximates" the right figure. Duke advances no reason why the FCC methodology is an inaccurate means for stating tax accruals, nor any evidence that Duke's situation is "unique" compared with any other multi-service utility which has had its rates calculated under Commission formula.

28. The Commission has explained many times the basis for its computation. See, e.g., American Television & Communications Corp. v. Northern States Power Co., PA-82-0069, Mimeo 6627 at ¶10 (Sep. 22, 1983); Group W Cable, Inc. v. Interstate Power Co., PA-80-0070, Mimeo 3118 at ¶14 (March 27, 1984), rev. denied, FCC 84-439, Mimeo 35089 (Sep. 20, 1984). Duke has offered no substantial basis for departing from this methodology.

F. No Change Is Required in ADIT Computations

29. Duke claims that its ADIT may be better approximated by using publicly reported ADIT figures breaking out electric-only ADIT (numerator) and electric only investment (denominator) from water and transit accounts. Duke has not presented the underlying FERC Form 1 either to TeleCable or to the Commission. Even if the Commission chooses to waive the prerequisite filing using Duke's more refined ADIT calculation, the net result is an additional 2 cents in the pole rate.

G. No Greater Description of Settlement Procedures Is Required

30. Duke suggests that Cencom failed to contact it prior to filing Complaint.

31. TeleCable took the lead in private negotiations which revealed differences too great to be resolved privately.

Duke's personnel stated that no reduction would be made for any operator without FCC order. Duke's pleadings make its recalcitrance quite clear.

32. The Commission has long held that settlement efforts are not required if the differences between the parties are vast. E.g., Teleprompter Corp. v. Northwestern Bell Tel. Co., 49 R.R.2d 557, PA 79-0043, Mimeo 00345 (Apr. 21, 1981). Under the circumstances, Cencom was not required to have the undersigned lawyer (employed jointly with TeleCable) to be shown the door once again at Duke's offices.

CONCLUSION

There is no basis for the Answer to depart from the $4.19 rate requested in the Complaint. If any credence is given to Duke's "Hugo" contentions, the rate would increase only to $4.22.

Respectfully submitted,

CENCOM CABLE INCOME PARTNERS, II, L.P.
CENCOM CABLE ENTERTAINMENT, INC., and
CENCOM CABLE TELEVISION, INC.

By ______________________
Paul Glist

COLE, RAYWID & BRAVERMAN
1919 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 659-9750

Its Attorney

Dated: March 6, 1991

A F F I D A V I T

STATE OF MISSOURI)
) ss:
COUNTY OF ST. LOUIS)

I, Trudi McCollum Foushee, an officer of Cencom Cable Income Partners, II, L.P.; Cencom Cable Entertainment, Inc.; and Cencom Cable Television, Inc. on oath do state that I have read the foregoing Reply attached hereto; that I am familiar with the matters contained therein and know the purpose thereof; and that the facts set forth therein are true and correct to the best of my knowledge, information and belief.

Trudi McCollum Foushee

Name: Trudi McCollum Foushee
Title: Counsel/Assistant Secretary

Subscribed and sworn to before me
this 26th day of FEB, 1991.

Notary Public

My Commission Expires: COMMISSION EXPIRES DEC. 12, 1994
State of Missouri
County of St. Louis

EXHIBIT C

D878000

12/21/89 706648

Duke Power

ANNUAL REPORT TO SHAREHOLDERS

47

HURRICANE HUGO DEVASTATES THE CAROLINAS

DUKE/FLUOR DANIEL TO BUILD COAL PLANTS

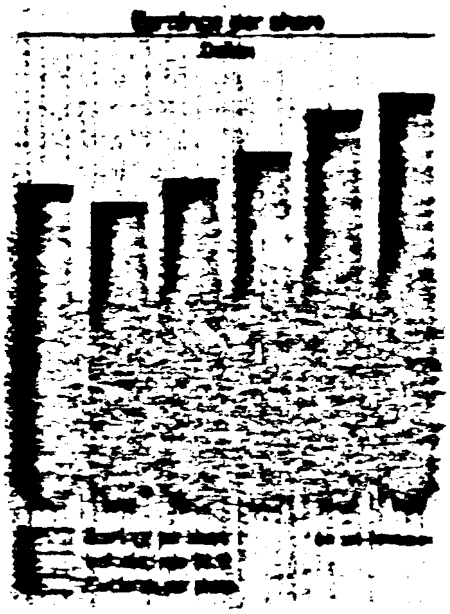
MARKETING POWER IN THE '90s

[illegible]

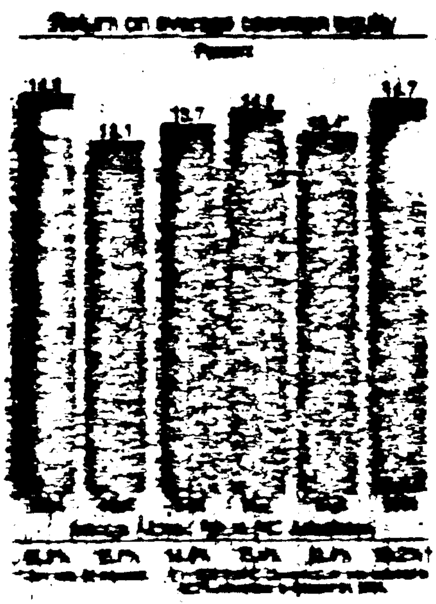
Financial Highlights

	1989	1988	Percent increase (decrease)
Kilowatt-hour sales (millions)	66,998	66,364	1.0
Electric revenues	$ 3,639,339,000	$3,626,985,000	0.3
Earnings for common stock	$ 519,134,000	$ 497,057,000(a)	4.4
Common stock data			
Average shares outstanding	101,277,000	101,266,000	—
Earnings per share	$5.13	$4.91(a)	4.5
Dividends per share	$3.04	$2.88	5.6
Book value per share (year-end)	$36.10	$34.01	6.1
Return on average common equity	14.7%	13.4%(b)	9.7
Plant construction costs	$ 872,577,000	$ 797,024,000	9.5
Nuclear fuel construction costs	$ 187,662,000	$ 152,243,000	23.3
Internal cash generation	73%	79%	(7.6)
Earnings coverage of fixed charges, SEC method	4.26X	4.25X(a)	0.2
Total electric plant, net	$ 7,917,295,000	$7,373,696,000	7.4
Peak load (kw)			
Summer	13,611,000	13,618,000	(0.1)
Winter	13,126,000	12,728,000	3.1

(a) Includes the cumulative effect of the accounting change for unbilled revenues.
(b) Excludes the cumulative effect of the accounting change for unbilled revenues, and the provision for loss associated with court affirmation of the Federal Energy Regulatory Commission order denying recovery of abandonment cost in supplemental power rates to the other joint owners of Catawba.



Earnings per share grew in 1989, with lower maintenance expenses and higher kilowatt-hour sales.



The Company's return on average equity remains strong.

Contents

To Our Shareholders:

In 1989 Duke Power:
— met Hurricane Hugo head-on;
— improved earnings;
— expanded its related, diversified businesses;
— prepared itself for the challenges ahead in the 1990s.

Hurricane Hugo

In one night of fury, Hurricane Hugo wracked the Company's service area, destroying much of a distribution system that took the better part of 80 years to build. Interrupting service to more than 40 percent of Duke Power's customers, the storm sparked the most massive clean-up and repair effort in Company history.

Duke Power crews began their repair efforts the morning of September 22, even before the storm winds had fully abated. Over the next few days, additional crews from as far away as New Jersey, Indiana, Mississippi and Florida joined our effort to restore power to nearly 700,000 customers. Almost 9,000 workers ultimately worked on the storm recovery effort.

William S. Lee

Over the next two-and-a-half weeks, these workers labored up to 16 hours a day to rebuild Duke Power's distribution system. The size of the job was unprecedented; the dispatch with which the work was completed underscored Duke Power's commitment to our customers. Duke Power, its suppliers and its contractors did not rest until every customer's service was restored.

At the same time, our customers responded to the hardship, discomfort and inconvenience with great concern, unswerving support and heartwarming good humor.

How Duke Power, its employees and its customers met the challenges posed by Hurricane Hugo is the subject of a special section beginning on page 14.

Earnings Improve

Earnings for 1989 were $5.13 a share, up from $4.91 a share in 1988.

While total kilowatt-hour sales rose just one percent, sales billed to commercial and industrial customers were healthy, increasing four percent and three percent, respectively. Sales billed to residential customers rose just under one percent.

Following a North Carolina Utilities Commission order reducing the Company's allowed return on equity to 13.2 percent, 1989 earnings were lowered by 11 cents per share.

Earnings were not significantly affected by Hurricane Hugo or a series of tornadoes that struck the service area in May. A broader discussion of the Company's earnings is included elsewhere in this report.

Expanding Opportunities

Duke Power and its affiliates forged new partnerships in 1989 in further efforts to develop non-utility opportunities.

Duke Power and Fluor Corporation of Irvine, Calif., entered into a partnership to create Duke/Fluor Daniel, which will provide a full range of services for coal-fired projects to electric utilities, independent power producers, cogenerators and industrial power producers. The new partnership brings together Duke Power's perspective and expertise as a premier coal-plant designer and operator with the world-wide resources and experience of the nation's largest engineering and construction firm.

New orders for baseload plants in the United States are estimated to reach 24,000 megawatts within five years. Coal-fired plants are expected to provide up to one-third of this capacity, and Duke/Fluor Daniel will be a strong competitor for a major portion of this business.

While Duke/Fluor Daniel will concentrate on serving the coal-fired sector of the industry, Duke Engineering & Services, Inc., our affiliate formed in 1987, will continue to focus on nuclear, hydro, and transmission and distribution services.

In June, Duke Power and four other companies announced the formation of Louisiana Energy Services to develop by 1996 the first privately owned uranium enrichment facility in the United States. By using proven gas centrifuge technology, the Claiborne Parish, La., plant intends to provide a domestic alternative to the federal government's uranium enrichment services. Enrichment is one of several steps necessary to prepare uranium for use as nuclear fuel. It historically accounts for about 40 percent of nuclear fuel costs.

Subsidiary To Be Sold

In October, Duke Power offered for sale Mill-Power Supply Company, its electrical equipment and high-tech electronic controls supply subsidiary. Mill-Power was formed in 1910 at the specific direction of Company founder James Buchanan Duke, so the decision was not an easy one. Mill-Power's operating results, however, are not material to consolidated earnings and have no prospect for becoming so without a far greater commitment of management and financial resources than the Company could justify. Our intent is to sell the entire subsidiary as an operating business, which we believe is advantageous to Mill-Power employees and Duke Power shareholders.

Toward Greater International Understanding

A high point of 1989 was the formation of the World Association of Nuclear Operators (WANO), an international organization dedicated to furthering nuclear plant safety and reliability.

Ultimately, operators of more than 400 nuclear power stations around the world will be linked by computer to share and disseminate operating information, lessons about significant events and technical assistance. Personnel from nuclear plants in the United States, Cuba, Europe, the Far East and the Soviet Union have already begun a series of technical exchange visits as part of the commitment to shared safety expertise.

The significance of WANO lies in its membership's interdependence. Transcending political and international boundaries, WANO members include every owner/operator of an electricity-producing reactor throughout the world. Recognizing that the safety of each nuclear station is important to all, worldwide WANO members have launched a quest for excellence through cooperation.

Clean Air Legislation Will Affect Duke Power

An emerging issue that will affect Duke Power in the future is the Clean Air Act proposal put forth by President Bush's Administration in 1989. As currently drafted, the act's provisions unfairly penalize Duke Power by denying the Company credit for having already reduced emission levels to among the lowest in the industry. The act as drafted would substantially and unnecessarily increase the cost of electricity generated by the Company.

Duke Power has actively contributed to the quest for a cleaner environment through the use of low-sulfur coal in our fossil-fueled plants and has emphasized nuclear power and efficiency in coal-fired generation to keep our air clean. We have asked key customers, our shareholders and employees to express their views about a fair, effective and efficient solution to the problem of air pollution.

Doug Booth Retires

After 37 years of service, Duke Power President Douglas W. Booth retired August 1. His wisdom, fairness and dedication to Duke Power have made it a real privilege to work with him over the years. We will miss him.

During his career Doug was responsible for many substantial accomplishments, including initiating the Company's Load Management Program and orchestrating the successful sale of portions of the Catawba Nuclear Station to municipalities and electric cooperatives.

In July, he was elected a Director Emeritus of the Company.

We are saddened by the death of former Board member Dr. Naomi G. Albanese, retired Dean of the School of Home Economics at the University of North Carolina at Greensboro. Joining the Board in 1975, Dr. Albanese brought an important perspective on the employees' role in the Company's success until her retirement in 1989.

We also will remember the leadership and contributions provided by Tom Berry, vice president, Southern Division, who died in March. Tom was a real community leader whose courage and vision inspired thousands of Duke Power employees during a career spanning 31 years. We will miss him.

Looking To the '90s

1989 was a successful year in many ways. We made progress in building our non-utility businesses, boosted income and strengthened the Company for the years ahead. Since 1986, the Company increased per-share earnings and its dividend while reducing rates to our customers three times.

These accomplishments are particularly significant in light of the challenges Duke Power will face in the 1990s. Issues such as the increasing competition from gas companies, municipalities and co-ops; the Public Utilities Holding Company Act and the limitations it places on Duke Power and its subsidiaries; increased environmental protection awareness, and future generating needs are constantly under review by Company management. These forces are reshaping the face of the electric utility industry, and Duke Power is answering by becoming a more customer-driven, cost-effective and responsive company.

Duke Power employees are participating in this effort with enthusiasm and commitment, realizing that change is not only inevitable, but necessary if Duke Power is to succeed in the '90s. Their performance during 1989, and particularly during the stressful days following Hurricane Hugo, is in the best tradition of Duke Power and signals their readiness for the decade ahead.

As always, we greatly appreciate the interest and support shareholders have shown throughout the year. An informed, supportive ownership is the foundation on which success is built. ▾

William S. Lee

William S. Lee
Chairman and President

February 9, 1990